A regional approach

Strong economic and demographic fundamentals in the UK regions are creating private rented sector opportunities comparable with those in the capital, writes Philip Nell, fund director of the VISTA UK Residential Real Estate Fund

London provides attractive opportunities for institutional property investors seeking to access the growing private rented sector (PRS). However, with price growth far outstripping wage growth, investors should consider looking elsewhere for the type of yields generated by PRS properties in the capital.

Growth by the numbers

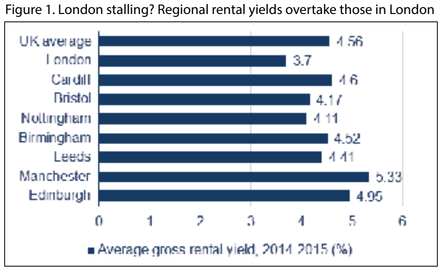
Regional UK economies were slower to recover from the recession than London but now post consistently strong economic data. The North and South West reported faster growing employment and faster falling unemployment than London in the year to September 2015, according to the Office for National Statistics (ONS). In the same period, the largest increase in workforce jobs occurred in the South West.

In addition, regional cities tend to have younger average populations than the national average. Nottingham had the highest proportion of 18-22 year olds at 15.5%, while the average age of the population of Bristol is projected to rise to 34.5 by 2037, almost 10 years younger than the national average. Because over 50% of private renters are aged between 16 and 34 years, such demographics are supportive of PRS investment.

The overall populations of regional cities are growing at a faster rate than in London, according to the ONS, and continue to face a shortfall in new housing. In the decade to 2011, the population growth of Manchester, at 28%, was double that of London at 14%. Birmingham, Edinburgh and Bristol recorded growth nearing that of London at 10%, 11% and 13% respectively.

This supports house prices, which are rising from a relatively subdued base compared to London, increasing prospective yields. In Manchester, average prices rose 4% between 2014 and 2015 and rents have increased by a similar proportion, resulting in an average gross rental yield of 5.33%, according to LendInvest. This compares favourably with the 3.7% yield offered in London *[see figure 1]*. As operating costs can be relatively high at up to 30% of gross rents, having a scaleable management platform makes these opportunities more viable.

Figure 1. London stalling? Regional rental yields overtake those in London



Source: Lendinvest as at 12 February 2015.

Companies on the move

In the last year, HSBC moved its retail banking business, and over 1,000 jobs, to Birmingham. This followed a similar decision by Deutsche Bank, which transferred over 2,000 jobs to the city. J.P. Morgan has moved thousands of jobs to Bournemouth and Scotland, where Morgan Stanley has joined it.

Businesses have good reason to move jobs out of London. In the City, office space costs £74ft^2 on average, while in central Birmingham and Manchester businesses can expect to be charged £31.50 ft2 and £32 ft^2 respectively at the top end of the market, according to CBRE. This difference is exacerbated by the addition of business rates, which are based on rental values.

Cross-party support

The main political parties are keen to boost economic growth outside London. The coalition government's 'Northern Powerhouse' plan, which aims to grow the North West's economy by 50% more than its long-term average in the years to 2030, resulted in growth of 3.1% in 2014, coming second only to London's 3.7%. More broadly, the Regional Growth Fund (RFG), which was launched in 2010 and has invested £2.7 billion in its first five years into local businesses across a range of sectors, has helped create 149,000 jobs.

PRS development is encouraged through the £1 billion 'Build to Rent' fund, which supplies finance for purpose-built PRS housing, alongside a £10 billion debt-guarantee scheme. It provided £4.1 million to 23 local authorities to deal with particularly bad landlord practices, indicating that it seeks better standards in the market. The removal of mortgage interest tax relief for private landlords and the introduction of an additional 3% stamp duty for second homes will make individual landlords, who currently dominate the PRS market, less competitive. These measures, coupled with the plan for guaranteed planning permission for brownfield sites, should aid the construction of institutionally owned and managed PRS properties and reflects the growing requirement for this form of housing.

The VISTA UK Residential Real Estate Fund is a joint venture between Hermes and Countrywide. Hermes is responsible for the regulated activities associated with the product. Countrywide is responsible for recommending potential properties and property maintenance. This article contains the views of Philip Nell as at February 2016 and may not necessarily represent the views expressed or reflected in other Hermes communications, strategies or products.